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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20555

In the Matter of:	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992; Rate Regulation	)	MM Docket No. 93-215
	)	DOCKET FILE COPY ORIGINAL
and	)	
	)	
Adoption of a Uniform Accounting System for Provision of Regulated Cable Service	)	CS Docket No. 94-28

REPLY BY THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY
TO COMMENTS OF SOUTHWESTERN BELL, TCI AND CABLEVISION

Southwestern Bell agrees with SNET that the Commission cannot rationally regulate the manner in which a price-cap-regulated LEC allocates common costs between telephony and non-regulated service (including multi-channel video service) without regulating in the same way the manner in which a price-cap-regulated cable TV operator allocates common costs between cable and non-cable service (including telephony). The Commission justifies regulating the allocation of costs by a price-cap-regulated LEC because it believes a LEC has market power in the provision of telephony. This same theory obviously requires regulation of a price-cap-regulated cable operator's allocation of costs since the Commission has held that cable operators have market power in the provision of multi-channel video service.

While Southwestern Bell agrees with SNET that identical cost allocation rules should govern price-cap-regulated cable TV operators and price-cap-regulated LECs, it contends that the affiliate transaction rule amendment SNET proposes would treat cable operators differently than LECs. In its petition, SNET asks the Commission to apply the cable TV affiliate transaction rule to a transaction in which a price-cap-regulated cable operator provides network transport service to a telephony affiliate. Southwestern Bell claims this amendment would treat cable operators differently than LECs because it believes the LEC affiliate transaction rule applies only to a transaction in which a LEC provides a regulated service to its affiliate, and it believes provision of transport service involves provision of an unregulated service.[1/]

Contrary to Southwestern Bell's belief, the LEC affiliate transaction rule applies when a LEC provides broadband transport service to an affiliate so the affiliate can provide multi-channel video service since the provision of transport service is a regulated service for purposes of the accounting rules. Provision of broadband transport is not inherently different from provision of narrowband transport. Both entail the carriage of voice, data, or video information necessary to provide communications service to consumers.

However, even if the Commission found that a LEC which provides broadband transport to an affiliate is providing that

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[1/] Southwestern Bell Comments at 3-5.

affiliate with an unregulated service, the service still would be subject to the affiliate transaction rule:

> "[A] carrier providing nonregulated services to the carrier's nonregulated affiliates is subject to the Commission's affiliate transaction rules. . . . When a nonregulated activity is accounted for within the system prescribed in Part 32 of the Commission's rules, pursuant to Section 32.23(c), the transactions between the carrier performing that nonregulated activity and a nonregulated affiliate are subject to the affiliate transactions rules prescribed in Section 32.27."[2/]

Unlike Southwestern Bell, TCI, in its comments on SNET's petition, does not dispute SNET's conclusion that existing affiliate transaction rules regulate a LEC's provision of broadband transport service to its affiliate while permitting price-cap-regulated cable operators and their telephony affiliates to enter comparable agreements free of regulation. Instead, TCI claims that this disparate regulatory treatment is warranted because LECs may provide their video affiliates with transport in order to facilitate improper cross-subsidization whereas comparable agreements between cable operators and their telephony affiliates occur only if they are economically efficient.[3/]

That argument is ridiculous. The same rationale that justifies regulating transactions between price-cap-regulated LECs and their video affiliates applies equally to price-cap-regulated cable operators and their telephony affiliates. The Commission regulates transactions between LECs and their affiliates because

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[2/] Citizens Utilities Co. Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs, Memorandum Opinion and Order, DA 96-556, ¶ 10 (Common Carrier Bur., rel. Apr. 22, 1996).

[3/] TCI Opp. at 2-3.

LECs are deemed to have an incentive to misallocate video service costs to telephony given the Commission's belief that LECs have market power in telephony. Price-cap-regulated cable operators have at least as great an incentive to misallocate telephony costs to cable service since the Commission has concluded that cable operators have market power in multi-channel video service.

Cablevision makes three additional arguments in its opposition to SNET's petition, but none has merit.

First, Cablevision claims that the amendment SNET requests is beyond the scope of this proceeding since this proceeding deals solely with amendments to affiliate transaction requirements applicable to cost-of-service-regulated cable operators, whereas SNET requests revision of the affiliate transaction requirement applicable to price-cap-regulated cable operators.[4/] In fact, the Commission sought comments in this proceeding on what regulations should govern transactions between cable operators and affiliates without regard to whether the price of the operators' service is controlled by cost-of-service regulation or price-cap regulation. Indeed, some cable operators filed comments urging the agency to eliminate all regulation of transactions between all cable operators and their affiliates, including price-cap-regulated cable operators.[5/]

[4/] Cablevision Opp. at 5-9.

[5/] See, e.g., Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992; Rate Regulation, Second Report and Order, 11 FCC Rcd. 2220, 2276 (1996) (discussing proposal by Time Warner to eliminate all regulation of transactions between all cable operators and their affiliates).

Cablevision next claims that there is no need for the FCC to regulate the allocation of a cable operator's network costs between cable and telephony because telephony affiliates of cable operators do not presently use network facilities of their affiliated cable operators to provide telephone service.[6] Even if that were true, it is irrelevant. The FCC regulates the manner in which a LEC allocates network costs between telephony and video services even though, to SNET's knowledge, very few LEC affiliates presently use the telephone network of their affiliated LECs to provide video service on a commercial basis.

Moreover, even if few cable affiliates use the network of their affiliated cable operators to provide telephone service today, that will soon change. In Connecticut, for example, Cablevision has spent $250 million to upgrade its cable network, and it has formed a telephony affiliate which has announced its intention to use Cablevision's upgraded cable TV network to provide telephone service. TCI likewise has upgraded its Connecticut cable TV network, and its telephony affiliate is now using that network to test market telephone service. Moreover, the TCI telephony affiliate has announced its intention to use TCI's cable network to provide telephone service in Connecticut on a commercial basis before the end of 1996.

Finally, Cablevision argues that the FCC need not regulate the manner in which a price-cap-regulated cable operator allocates network costs to its telephony affiliate because the Commission

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[6] Cablevision Opp. at 10-13.

does not care whether a price-cap-regulated cable operator misallocates telephony costs to cable.[7] In fact, the FCC's cable TV price cap rules demonstrate that the opposite is true. Those rules ordered cable operators to lower their cable rates to a cost-based level after finding that a typical cable operator's rates were 17 percent higher than would be the case if rates had been based on cost.[8]

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[7] Id. at 14-18.

[8] Rate Regulation, Second Order on Reconsideration, 9 FCC Rcd. 4119, 4123-24 (1994), aff'd in pertinent part, Time Warner Enter. Co. v. FCC, 56 FCC Rcd. 181 (D.C. Cir. 1995), reh'g denied, July 17, 1995 (finding that cable operators who face insignificant competition charge 17 percent more for cable service, on average, than cable operators who face significant competition); id. 9 FCC, Rcd. at 4128 (finding that cable operators who face competition provide cable service at a price based on the true economic cost of providing service).

CONCLUSION

The Commission should modify the affiliate transaction rule applicable to cable TV operators in the manner described in SNET's petition.

Respectfully submitted,

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<u>Certificate of Service</u>

I certify that, on May 28, 1996, I mailed a copy of the foregoing "Reply by The Southern New England Telephone Company to Comments of Southwestern Bell, TCI, and Cablevision" to the following:

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